THE FEDERAL TRADE COMMISSION: THE DEVELOPMENT OF THE LAW WHICH LED TO ITS ESTABLISHMENT

JAMES A. FAYNE

Boston, Mass.

It was Munn vs. Illinois[1] that first interpreted the constitutional provision empowering Congress to regulate commerce[2] in such a way as to charge private business with a public interest. Since that epochal finding our courts have made comparatively swift progress, reaching ultimately (through the Standard Oil[3] and tobacco decisions) a federal trade commission to regulate competition in trade and to restrain illegal combinations.[4] All of this has been done during the professional life of many lawyers of today, for Munn vs. Illinois was decided in 1876.

Writers upon the trend of legislation and of court decisions had clearly predicted this last development of corporation law.[5] The incident of climax importance however, was the remanding of the oil and tobacco cases to the circuit courts where the decrees of dissolution were to be worked out in conjunction with the department of justice. This was administrative work, and a department of the executive branch of the government should do it. Hence the creation of the trade commission, empowered to investigate the carrying out of the decrees of the supreme court and to prepare the form of decree in certain cases referred to it by the circuit courts.

[1] (94 U. S. 113.)

[2] Art. viii, sec. 1.

[3] Standard Oil vs. U. S. 221 U. S. 1. U. S. vs. American Tobacco Co. 221 U. S., 66.

[4] Sec. 5 and sec. 6 of act to create federal trade commission.

[5] Wyman, *Control of the Market*, Chap. x, 238; Chap. xii, 277; Van Hise, *Concentration and Control*, Chap. v, 270.

Before analyzing the new commission it will be interesting to trace the development of court opinion by means of the cases which have brought us to our present conception of the law. Restraint of trade has been a topic of importance since the time of Elizabeth.[6] No ruling was made in this country, however, until 1876 when some farmers in Illinois sought to compel the firm of Munn and Scott, owners of a grain elevator, to store their grain without discriminatory charges. The proprietors, of course, insisted upon their inherent private property rights. The court defined the limits of private property rights under the common law, and, quoting Lord Chief Justice Hale (De Portibus Maris) said, ". . . looking then to the common law, from whence came the right which the constitution protects, we find that when private property is 'affected with a public interest, it ceases to be juris privati only.' " And the court found that the warehouses of the plaintiffs in error were so charged with a public interest.[7]

This was sure footing for a beginning. The court was clear and decisive in its position. Henceforth, even at common law, there was to be a public regulation of business "clothed with a public interest." We were soon to see a statutory qualification. Eleven years later, namely, in 1887,[8] Congress created the interstate commerce commission to regulate transportation rates. Lively opposition greeted the new board and "a time of suspended activity" in business was freely predicted.[9] Indeed, the public itself seemed not to understand the powers of the commission, and for some time the commission was not very effective.

The board, however, exercised its regulatory powers and the railroads did not become bankrupt. Public opinion gradually

[6] Stimson, F. J., Lectures, *Tendencies of American Legislation.*

[7] The court said: "Rights of property which have been created by the common law cannot be taken away without due process; but the law itself, as a rule of conduct, may be changed at the will, or even at the whim, of the legislature, unless prevented by constitutional limitations. Indeed, the great office of the statutes is to remedy defects in the common law as they are developed and to adapt it to the changes of time and circumstances."

[8] Approved, Feb. 2, 1887.

[9] Fin. Chronicle, vol. xlvi, 70, 100, 133.

came to approve of its existence and there were audible mutterings about government control of industrial corporations as well. These found expression in a few years (1890) in the enactment of the Sherman anti-trust act[10] to restrain combination or conspiracy, the intent of which was to monopolize trade.

The armament of the "trust busters" was now deemed adequate; a commission to regulate railroads, and an anti-trust statute to cover everything else in interstate trade. But public opinion was again slow to apprehend.[11] The common law had declared a trust illegal[12]—what the Sherman act could do in addition, no one seemed to know. The spirit of the times was anti-trust. There was no doubt of that and the court had taken judicial notice of it.

In this state of confusion the "trust" lawyers decided to turn the new law to their own use. In 1894 they sought to have the combination clause of the act made applicable to the labor organization which called the great railroad strike, and they succeeded.[13] Indeed, Eugene V. Debs went to jail for contempt of the court's injunction. Here was a use of the Sherman act probably never contemplated by its framers. Incidentally, it illustrates the error of those of our own day who believe that labor unions are exempt from the law.

The next attempt to apply the Sherman act came in 1895 and this time it was against a corporation.[14] A company manufacturing sugar in Pennsylvania which was sold in New York, was held to be outside the pale of the law, for manufacture was held not to be interstate commerce and this was so whatever the intention of the manufacturer.[15] So far, corporations had profited by the law.

[10] Approved July 2, 1890. First three sections prohibit restraint and monopoly and seventh section gives party injured treble damages.

[11] Wyman's *Control of the Market.*

[12] People vs. North River Sugar Rfg. Co. (121 N. Y., 582).

[13] In re Debs (158 U. S., 564).

[14] U. S. vs. E. C. Knight (156 U. S. 1).

[15] The case turned on a close vote of 5 to 4. It has since been thought that the government attorneys were no match for the trust lawyers. At any rate, the view then announced, that manufacture was not commerce, has not since

Two years after the labor case the tables were turned and the Sherman act received its first anti-corporation interpretation, when an agreement between railroads west of the Mississippi affecting freight moved within the so-called Missouri river territory (a typical pool) was held to be an attempt to restrain trade.[16]

Even the majority opinion in the Knight case assumed that transportation was within the Sherman act, but it still remained for a court to include everyday commerce. And to those who believe the present Democratic administration to be anti-corporation in establishing the trade commission, it may be of interest to learn that William Howard Taft was the first judge to apply the Sherman act to the ordinary industrial combination. The Addystone Pipe case[17] came up to the supreme court on appeal from the circuit court opinion written by Judge Taft, and that opinion was affirmed. Incidentally, it is worth noting that the case was one of the citations made by Chief Justice White in justifying the conclusions of the supreme court in the 1911 trust case.

Judge Taft's opinion defined interstate commerce very inclusively. It said, ". . . the soliciting of orders for, and the sale of goods in one state, to be delivered from another state, is interstate commerce in its strictest and highest sense." There was no doubt now as to whether the Sherman act applied to anything except transportation. The courts might vary the form of attack, but by 1899 they had clearly decided that every kind of interstate business was covered by the Sherman act.

been urged. Instead manufacture is regarded as one step in a scheme the entirety of which may amount to intercourse and trade, and when this trade is between states it comes within the Sherman act. It will prove interesting to read the ground taken by Justice Harlan who wrote the minority opinion.

[16] Trans-Missouri Freight Association (166 U. S. 290).

[17] U. S. vs. Addystone Pipe and Steel Co. (175 U. S. 211). This, briefly, was an association of pipe manufacturers with elaborate rules which precluded individual members from bidding upon jobs until the association had sold the right to go after the job to the member bidding the most for the privilege. Once a job was "sold" to a member, he was to be left free to get the best price he could without competition from others.

And its next application was a variation in form of attack—a stretching of the law to include holding companies.

In the Northern Securities case the court said that a combination of two previously existing companies, effected through the common control by a third company, must not destroy competition, either actual or potential. This unquestionably struck at the legal device of a single company holding control of actual competitors. The end of industrial combination through the medium of the holding company was now in sight.

Public opinion very readily condemned Standard Oil and American Tobacco as huge holding devices, but it was only after some years of spectacular litigation[18] that the companies had their "day in court." So that, in 1909 when the cases reached the supreme court, that tribunal was chiefly concerned not with the question of legality but with the question of dissolution. By this time, the following had been accomplished:

The trust had been definitely held illegal.[19]

The pool was plainly wrong.[20]

The holding company ceased to exist in interstate trade.[21]

The single corporation had been found objectionable to some state courts,[22] and perfectly acceptable to others.[23]

The oil and tobacco companies had already been condemned at the tribunal of public opinion and courts could be counted upon to take cognizance of the situation. But public opinion also favored something constructive. And Chief Justice White's opinions in the oil and tobacco cases offered a happy solution of a bothersome problem. Competition was to be restored by the circuit courts and the department of justice in pursuance of the court's decree.

[18] Standard Oil had been fined $26,000,000 in the lower courts. American Tobacco had had the treble damage recovery clause of the Sherman act enforced against it.

[19] People vs. North River Sugar Rfg. Co. (121 N. Y., 582).

[20] Trans-Missouri Freight Association (166 U. S. 290).
White Star Line vs. Star Line (141 Mich. 604).

[21] Northern Securities (193 U. S. 197).

[22] Atty. Gen. vs. Booth (143 Mich. 84).

[23] Trenton Potteries vs. Oliphant (58 N. J., equity, 507).

This ruling made necessary the new federal trade commission, for courts could not continue indefinitely to supervise the corporations they were forced to create. The dissolution of the Standard Oil Company created thirty-three separate corporations where before (1909) there were sixty, and segregated the tobacco company into fourteen companies. Some of these new corporations have capitalizations as high as $100,000,000. Thus the "big corporation" as an institution was judicially noticed. Unregulated competition was at an end. Regulation of competition is administrative work for an executive department. Hence the federal trade commission.

This is the legal genesis of the trade commission. Its functions are very elaborately prescribed in the law, and court decisions indicate how the commission is to exercise them. The commission must see to it that trade is not restrained, either by unfair competition or illegal combination. This work is not new, but it is an innovation to have a department of the government doing it. In addition the commission is to act as a statistical department for the nation, making investigations and reports concerning corporations and industries, domestic and foreign trade, etc.

But it is with its quasi-judicial powers we are concerned. Section 5 of the act prohibits unfair methods of competition and empowers and directs the commission to prevent persons from using them. The criticism has been made that this provision is unconstitutional.[24] But there seem to have been interpretations enough to indicate what the courts will regard as "unfair methods of competition," and in the last analysis it is the court holding that will really count, for all orders of the commission may be reviewed, upon petition, by the circuit courts of appeal. In a broad way, "that is held to be fair which the community regards as consistent with its safety; that is held unfair which the

[24] Fin. and Com. Chronicle., vol. xcix, 694, quotes Robt. R. Reed as follows: . . . "unfair competition . . . was recognized by the courts and in effect covered only unfair acts tending to the destruction of competition—acts, that is, which could be committed only in the attempt to establish a monopoly. 'Unfair methods of competition' is capable of no such construction."

state considers dangerous to its peace."[25] More specifically, courts have held that it is not an unfair method of competition to make a representation concerning goods offered for sale by a rival so long as there is no imputation upon the rival individually, but only upon the goods which might be handled by anybody. So when a tradesman said that lubricators offered for sale by a rival were not good for that purpose but wasted the tallow, there was "damnum sine injuria."[26] It was held to be a fair method of competition for R. to make a preparation and call it "cherry pectoral" even though A. had for years been selling a preparation by that name, and the words had long been associated with his product. And R. could advertise as follows: "A.'s Cherry pectoral, $1; R.'s, 50 cents, which will you have?"[27]

Puffing statements have been held to be a fair method of competition, even when you wrap up a commodity in a paper bearing an advertisement of another brand of the same commodity, which advertisement says the second brand is better "than any other preparation yet offered."[28] It is a fair method of competition to put out goods in a way similar to that in which another brand of the same goods is handled, since these ways are common to the business concerned.

But it is an unfair method of competition to induce another to break a contract entered into with a rival even though the other contracting party had not begun its performance.[29] This is so in the case of a single contracting party as well as where many are concerned.[30] But query, where in spite of a pre-existing contract, one in absence of fraud, induces another to sell certain goods to him at a higher price than the vendor had already agreed to sell the same goods to another, and the purchaser knew of such earlier agreement.[31]

[25] Wyman, *Control of the Market*, Chap. iii.
[26] Evans vs. Harlow (Q. B. 1844).
[27] Ayer vs. Rushton (7 Daly 9).
[28] White vs. Mellin (House of Lords, 1895).
[29] Lumley vs. Gye (Q. B. 1853).
[30] Glamorgan Coal Co. vs. So. Wales Miners' Fed. (2 K. B. 545).
[31] Chambers and Marshall vs. Baldwin (91 Ky. 121).

Of course fraud is always an unfair method of competition but courts have gone further and said that it is unfair to appropriate the use of a geographical name which has come to acquire a special signification when applied to certain commodities.[32] Likewise the use of one's own name has been restricted under such conditions.

Enough has been shown to indicate that the commission should not have great difficulty in saying what are "unfair methods." The new view as evolved from the cases has been defined as holding that every man in business has the right to freedom from competition unless competition can be shown to be justified, whereas the ancient view was that one could do anything that was legal to get business.[33]

Similarly the cases indicate what the commission may be expected to do in regulating combination. Upon the application of the attorney general the commission is to investigate any corporation alleged to be doing business in violation of the anti-trust act,[34] and that corporation is to readjust its business in accordance with the recommendation made by the commission. Where a final decree has been entered in any suit brought by the government against a defendant corporation to prevent restraint of trade, the commission is to make, on its own initiative, investigations as to the manner in which the decree is being carried out.[35] This is the work done by the courts in establishing the reorganized oil and tobacco subsidiaries. It applies only to decrees "hereafter" entered, and it was necessary to introduce a Senate resolution (Senator Gore, Oklahoma, September 28) in order to have the commission supervise the manner in which the Standard Oil subsidiaries are carrying out the decree in that case. Finally, the legal work required provides that where the attorney general brings suit under the anti-trust act against any corporation the court may, upon completion of testimony, if relief is granted,

[32] Waltham Watch vs. U. S. Watch Co. (173 Mass., 85).
[33] Wyman, *Control of the Market*.
[34] Sec. 6, paragraph e.
[35] Sec. 6, paragraph c.

send the case to the commission as a master in chancery, to ascertain and report an appropriate decree.[36]

This briefly outlines the development of the law up to the cases calling the commission into existence. It will be interesting to note what has transpired since the trust cases of 1911. Primarily those cases indicated that the common law "rule of reason" was to be the determinant in saying whether combinations are in restraint. The court intimated that where a statute was enacted to give definiteness to common law principles existing at the time, common law standards should be adopted in interpreting the statute. And by common law, prior to 1890, only those combinations were objectionable which went to the point of monopoly in restraining trade. So we find in a recent Rhode Island case[37] the court declaring a combination not a monopoly and defining a monopoly as "any combination the tendency of which is to prevent competition in the broad and general sense and to control prices to the detriment of the public." Combinations for mutual advantage which do not amount to a monopoly, but leave the field of competition open to others are neither within the reason nor the operation of the rule. It isunreasonable restraint for manufacturers and dealers in patented goods, even though they own the patents, to combine and destroy competition.[38]

In a shoe machinery case the court held that manufacturers owning patents to machines required in the manufacture of different parts of a certain commodity may combine without violating the law.[39]

On the other hand, it has been held an unreasonable restraint to purchase patents held by a company, then buy up the majority stock of that company, pigeon-hole the patents and reduce the company to idleness.[40] And the salient feature of the Addy-

[36] Sec. 7.

[37] State vs. Eastern Coal Co. (29 R. I., 254) citing Oakdale Mfg. Co. vs. Garst (18 R. I., 484).

[38] U. S. vs. Patterson (205 Fed. 292).

[39] U. S. vs. Winslow (227 U. S., 202).

[40] Strout vs. U. Shoe Machinery Co. (202 Fed. 602).

stone Pipe case was again held to be unreasonable restraint in an Iowa case,[41] where an association of farmers agreed not to sell outside of the association without forfeiting to the association five cents per 100 weight for all grain so sold.

The principal cases that have been in the United States courts since the 1911 decrees are the Union Pacific merger case[42] and the International Harvester case.[43] The railroad case does not involve the subject matter of the trade commission, but it is interesting to note that in both cases no new expressions of opinion were recorded. And yet the Union Pacific decision is peculiarly instructive by way of restating what the law has been, for the court goes to great length to show that previous decisions construing the anti-trust act were harmonious and consistent with one another. The case differed from the earlier Northern Securities case[44] in that, in the earlier case, the control through a holding company device was condemned, whereas in this case the court points out that the direct holding by one company of the stock of a potential competitor is equally bad. And it makes no difference, apparently, that less than a majority of the stock is held, for in this instance Union Pacific owned only 46 per cent of the Southern Pacific stock, which the court held to be control. This is interesting as a measure of monopoly.

The Harvester case, which is the latest United States case, held that even though a corporation was singularly free from all the evils against which the law was directed, if it tended to destroy competition and establish monopoly it was in violation of the second section of the anti-trust act. And this was so even though, as in this case, no fault was found with the methods of doing business and there was "an absence . . . of all the elements of undue injury to the public and undue restraint of trade." This case is very interesting as it applies to the work of the new commission, for its chief concern is restraint of trade by those two methods—unfair competition and undue combination.

[41] Reeves vs. Decorah Farmers' Coöperative Society (140 NW, 844).
[42] U. S. vs. Union Pacific Rd. (226 U. S., 306).
[43] U. S. vs. Int. Harvester Co. (214 Fed. 987).
[44] (193 U. S., 197.)

Finally a New Jersey court decided last month[45] that a company cannot be said to have established a monopoly in any given community when other companies still continue to do business there, and in fact increase the total volume of business done in the commodity specified after the acts complained of (price cutting) had been done.

So that the cases since the oil and tobacco decisions of 1911 have established nothing that was not settled by the cases leading up to the creation of the commission. All that has been said on trade and commerce, the courts have been saying for many years. The commission, therefore, comes on to this field of combat with the "rules of the game" fairly well defined, and with the last court of the land having intimated clearly enough three things—just what are unfair methods of competition, just what is restraint of trade and just what is monopoly. To this extent, at least, it should not be difficult for the new board to coöperate with the business interests of the country, suggesting and recommending, and thereby reducing to a minimum the likelihood of disturbing suits for dissolution, which later can hardly be contemplated with equanimity in the existing delicate situation of commerce and finance.

[45] New Jersey Court Common Pleas, September 21, 1914.